Trends in Retail Competition: Private Labels, Brands and Competition Policy

Sector inquiry into the German food retail sector

Oxford 22th May 2015

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1. Challenges and purpose
2. Approach and structure of the empirical investigation
3. Sales market - Some results
4. Procurement markets / Structure
   • Analysis
   • Some Results
5. Procurement markets / Econometric Investigation
   • Survey techniques & data set
   • Estimation models – the important question of efficiencies
   • Robustness through variety
   • Some results
6. Consequences for the future application of competition law
1. Challenges and Purpose

**General Objective**
Improve **knowledge** of the dynamics in food retailing and **exploring** the market structure of the sales and the procurement markets.

**Challenges**
- Ongoing concentration process (→ Edeka/Kaiser’s Tengelmann)
- Discussion and complaints about buyer power
- The “new character” of buying alliances

**Purpose**
- Econometric insights in different – often theoretically discussed – aspects of buyer power.
- Identification of key drivers of buyer power. Better framework for assessment of (merger) cases
- Shedding (a spot)light on market structure
## 2. Approach and Structure

### Sector Inquiry Retail Food

<table>
<thead>
<tr>
<th>A. Downstream</th>
<th>B. Upstream (Procurement)</th>
</tr>
</thead>
</table>
| **Comparison of structural indicators:** | **Ia. Case Studies**  
(Analysis of seven individual, specially selected procurement markets) |
| - turnover |  |
| - total sales |  |
| - floor space |  |
| - outlet density |  |
| - customer reach |  |
| - distribution channel concepts |  |
| **Ib. Comparison of structural indicators**  
(Analysis of purchasing volume and other figures in every product category and overall & purchasing cooperatives) |  |
| **II. Econometric Analysis**  
(Estimation of econometric models based on a unique data set from a stratified sample) |  |
3. Sales markets
Some results

- high concentration, even increasing.
- slight assimiliation of the distribution channels, but graduated competitive relationship is still apparent.
- continuing course of expansion of Edeka and Rewe via mergers and buying alliances.
- problems of internal growth in particular for smaller retailers and newcomers.
- new generation of buying alliances.
- developments of private labels in terms of quantity and quality.
4. **Procurement markets:** Which product markets were analysed? ...which criteria are important?

- different product categories
- market size
- supplier and buyer structure
- the importance of private labels

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- procurement shares of the individual retailers
- the conditions of competition
Frozen Pizza compared with Milk

Frozen Pizza

market shares of the leading purchasers - total market

Frozen Pizza

55% leading purchasers

<5%

<5%

<5%

5-10%

10-20%

20-25%

Milk

market shares of the leading purchasers - total market

Milk

70% leading purchasers

<5%

<5%

5-10%

15-20%

15-20%

20-25%

Supplier

market shares (food retail market) of the leading suppliers

2010 - Frozen Pizza

85% leading suppliers

25-30%

15-20%

10-15%

5-10%

5-10%

<5%

Supplier

market shares (food retail market) of the leading suppliers

2010 - Milk

77.5% leading suppliers

20-25%

20-25%

15-20%

5-10%

5-10%

<5%

www.bundeskartellamt.de 22.05.2015
4. Procurement markets / Structure
Some Results I

- Markets for the procurement of **private labels and branded products** are most often **separate markets**, despite the high technical ability to switch production
  - The cost and distribution structures in the manufacture of branded products on the one hand and private labels on the other greatly vary in many cases
  - Increasing competition between upgraded private labels and branded products is an economic obstacle for manufacturers to produce private labels
- In all the procurement markets examined the **food retailers in Germany purchase** their goods primarily **from manufacturers in Germany**.
- In all the procurement markets examined the **food retail trade is the most important sales channel** for food manufacturers. Alternative distribution channels are declining.
4. Procurement markets / Structure
Some Results II

• The **group of leading food retailers** (Edeka, Rewe, Aldi, Schwarz Group) account for the largest share of total demand (in all the distribution channels including export) across all procurement markets and irrespective of whether private labels and branded products are in one market or not.

• On the **manufacturers’ side** a heterogenous leading group of at the most four to five companies of various sizes account for the substantial part of the goods and services supplied.

• **Shifting sales to another distribution channel** is either regarded as not economically viable or there is a lack of the "absorptive capacity" of alternative distribution channels.
5. Econometric Analysis
Survey techniques and data set I

Population:
Negotiations about branded products
(articles with an EAN)

1. All listed products with EAN
2. Stratified Sampling:
   - must stock
   - available at discounter
   - high-turnover
3. Data request to retailers and suppliers with (almost) the same content
4. Validation

Final Data Sets
Raw Data Sets
Final Data Sets

Variables (examples):
- volume / gross price / net-price / net-price
- purchasing cooperatives / terms of payment / brand / private labels / sales volume / „folding“

<table>
<thead>
<tr>
<th></th>
<th>Retailer data set</th>
<th>Supplier data set</th>
</tr>
</thead>
<tbody>
<tr>
<td># products/items</td>
<td>238</td>
<td>256</td>
</tr>
<tr>
<td># negotiations</td>
<td>2830</td>
<td>2987</td>
</tr>
<tr>
<td># observation</td>
<td>61.632</td>
<td>65.197</td>
</tr>
</tbody>
</table>
5. Econometric Analysis
Basic idea of estimation models

Linear (fixed effect) model...
...to estimate the conditions for the purchase of branded products (dependent variable)
...identify the key factors of successful negotiations (independent variables)

\[ condition_i = \text{const} + \alpha \cdot \text{volume}_i + \sum_{n} \beta_n \cdot \text{neg.factor}_{n,i} + \sum_{c=1} \gamma_c \cdot \text{control}_{c,i} + \sum_{k=1} FE - \text{Dummy}_{k,i} + \epsilon_i \]
5. Econometric Analysis
Robustness through variety

<table>
<thead>
<tr>
<th>Data Sets</th>
<th>Supplier data set</th>
<th>2 alternatives</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Retailer data set</td>
<td></td>
</tr>
<tr>
<td>Estimation (Models)</td>
<td>OLS 2010</td>
<td>6 alternatives</td>
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<tr>
<td></td>
<td>Instrumental</td>
<td></td>
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<tr>
<td></td>
<td>Variables</td>
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<td>OLS 2011</td>
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<td>Operationalization</td>
<td>Fixed Effects</td>
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<tr>
<td></td>
<td>Instrumental</td>
<td>alternatives</td>
</tr>
<tr>
<td></td>
<td>Variables</td>
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</tbody>
</table>

58,320 (alternative) estimation models were estimated!
(192 finally discussed in the report)
5. Econometric Investigation
Some results I

- Volume

- Outside-Options for Supplier (in terms of share of sale)

- Outside-Options for Retailer (in terms of share of sale)

- Brand Strength and Customer Perception

+ Impact of (other) branded products

? Impact of Private Labels

+ Further private labels in the segment
- Manufacturer provides retailer with private labels?

? Impact of Purchasing Cooperations

- Retailer is "junior partner" — but competition on quality / product range adaptation
- Retailer is the "head of a purchasing cooperation" — indeed successful negotiations without purchasing cooperations
5. Econometric Investigation
Some results II

- **High purchasing volumes** lead to low purchasing prices (no suprise!), leading retailers enjoy further economies of scale.
- They are "*gate keepers*" with regard to the penetration of the manufacturers products.
- Even **strong manufacturers** with high turnover shares in the food retail sector **can be faced with strong bargaining power** from their customers → check **outside options** on a case-by-case basis.
- In the assessment of bargaining power in bilateral negotiations, the **brand strength** of the products in question is taken into consideration. There is a need to determine to what extent the products of a certain manufacturer are indeed indispensable for the retail trade (about 6% of the sampling).
• The bargaining position of the retailer is usually strengthened if he also offers **private labels**/depends very much on the circumstances of the individual case.

• At the horizontal level, a retailer offering a **wide range** of **private labels and branded products** usually enjoys a structural advantage over its competitors.

• The "**new generation**" of **buying alliances** can be part of the consolidation of the market and improves the bargaining positions of the leading food retailers.
6. Consequences for the future application of competition law

• Each acquisition of a food retailer by one of the large retailers Edeka, Rewe and the Schwarz Group, requires an in-depth examination, also with regard to the procurement markets.

• As to the control of abusive practices, the sector inquiry provides important insights regarding the identification the addressees of the prohibition of inducing suppliers to grant a retailer specific benefits without any objective justification ("Anzapfverbot").

• The sector inquiry suggests that at least the large food retail companies Edeka, Rewe, the Schwarz Group and Aldi are norm addressees under the control of abusive practices.

• An assessment of whether a demand is objectively justified can only be made on the basis of the concrete facts in each individual case. The sector inquiry provides indications as to which bargaining scenarios are more or less likely to result in abuse practices.

• In particular the "new" buying alliances involving large companies must be carefully examined. They no longer merely represent a time-limited bundling of purchasing volumes, but must be seen as part of the concentration process with significant long-term effects on competition also on the sales markets.
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